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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000663

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SUBJECT: CONOCO-PHILLIPS VIEWS OF THE KAZAKHSTAN-AZERBAIJAN
OIL-TRANSPORT NEGOTIATIONS

Classified By: Charge d'Affaires Jason P. Hyland, reasons 1.4 (b), (d)
and (e).

11. (C) SUMMARY. ConocoPhillips executives believe the Azerbaijan-Kazakhstan IGA for trans-Caspian oil transport must be signed this year if the needed maritime infrastructure is to be ready by the time the oil flows, although they concede the deadline may be more flexible. Major issues for ConocoPhillips include whether it will be allowed to own or exclusively charter the giant tankers built for the program, and newly-appointed Finance Minister Samir Sharifov's idea to impose both transit fees and a profit tax on the project instead of just one or the other. ConocoPhillips is interested in possibly a TDA study of the potential benefits of improved maritime infrastructure in the Caspian. Post supports the idea of such a study because of the potential for this project to assist in Azerbaijan's development and economic diversification beyond the energy sector. END SUMMARY.

IGA NEEDED "THIS YEAR"

12. (C) In a recent meeting with Charge, ConocoPhillips Russia/Caspian Region President Dr. Kevin Meyers said that the InterGovernmental Agreement (IGA) between Azerbaijan and Kazakhstan for trans-Caspian oil transport needs to be signed this year. This will allow the necessary investments to be made in marine infrastructure before Kazakhstan's Kashagan field goes into production. Meyers also expressed the worry that the IGA negotiations could "punt" too many difficult issues to the follow-on Host Government Agreements (HGA) negotiated separately with Azerbaijan and Kazakhstan. ConocoPhillips wants to see a strong IGA that definitively addresses and settles the issues involved in the project.

13. (C) Regarding the selection of a tanker system as opposed to a pipeline as the method for bringing Kazakhstan's oil into BTC, Meyers said firmly "there is no technical or economic reason not to build a pipeline from Kazakhstan to Azerbaijan." Meyers said he felt the two countries had decided on shipping for different reasons, perhaps political ones connected to Caspian delimitation. Meyers also stressed

that BTC expansion is critical -- without expanding the capacity of the line, there naturally will be no room for Kazakhstan's oil.

AREAS OF INTEREST: OWNING SHIPS

14. (C) In a meeting April 22 with Energy Officer, ConocoPhillips Russia/Caspian Transportation Manager John Dabbar identified four areas in the draft IGA of particular interest to ConocoPhillips. The first of these is what the IGA refers to as the "Marine Transporter." ConocoPhillips had proposed language addressing the right of the north Caspian producers to own and/or charter ships to transport the oil. This language has been deleted and the issue essentially kicked to the HGAs. ConocoPhillips is worried about this because it does not want to invest vast sums to develop a tanker fleet for Azerbaijan and Kazakhstan that it then does not own or control. ConocoPhillips feels this issue has to be addressed. Until it is, Dabbar pointed out, ConocoPhillips and other investors will be reluctant to put money into maritime infrastructure for the project. The result is that, even if the IGA is signed in the very near future, the project will be pushed further into the future.

15. (C) Energy officer asked if the deadline of Kashagan production in 2009 is really a "hard" deadline, pointing out arguments by Azerbaijani officials in septel that production will take a while to build up. Dabbar conceded that the deadline is more flexible than the north Caspian producers imply in their public statements. However, Dabbar also noted that "time kills all deals" and the longer it takes to get this project going, the more likely that some north Caspian

BAKU 00000663 002 OF 003

producers will look at other potential export routes for their oil.

SPECIFYING KASHAGAN AND BTC?

16. (C) The second issue is the question of whether the IGA will specify the Kashagan field as the source of oil coming from Kazakhstan and whether it will specify BTC as the transportation mechanism across Azerbaijan. Dabbar said that his understanding is that the IGA now speaks of "any oil from Kazakhstan" and identifies the transportation mechanism as "primarily BTC." ConocoPhillips does not have a problem with this language and feels it will allow for rail transportation in extremis.

KARACHAGANAK

17. (C) A third issue involves a request by Kazakhstan that the IGA include language saying "this agreement is executed without prejudice to any border disputes." Dabbar feels this is about eventually bringing oil from the Karachaganak field, near the Kazakhstan-Russia border, into BTC without getting caught up in border issues. The GOAJ, says Dabbar, wants to look at this carefully and consult with its MFA, which has not been involved in the negotiations, before agreeing to it.

FEAR OF "DOUBLE TAXATION"

18. (C) The final issue leads back to Samir Sharifov, formerly head of the State Oil Fund and now Minister of Finance. Sharifov is talking about imposing both a transit fee on the north Caspian producers as well as a profit tax. Dabbar points out that, normally, either a transit fee or a profit tax is imposed on the transportation of oil across a second

country's territory -- not both. This amounts to double taxation and ConocoPhillips is strongly opposed to it. Dabbar pointed out that this matter is not addressed in the IGA but is still of concern. This may simply be a case of Sharifov asserting himself to get attention, said Dabbar. ConocoPhillips will be meeting with him to see "what it is he is really after."

MARITIME INFRASTRUCTURE: ROLE FOR TDA?

¶9. (C) Dabbar said that ConocoPhillips is seriously looking at the question of shipbuilding in Azerbaijan for this project. Even if the actual hulls are assembled elsewhere, Dabbar pointed out, there is the question of training sailors, upgrading ports, and other related matters. Dabbar asked if it might be possible for TDA to undertake a study of the conditions necessary to re-establish Azerbaijan's shipbuilding infrastructure, which died out after the Second World War. Such a study would help Azerbaijan realize the positive effects of the project. It would also give ConocoPhillips and Chevron, pursuing its own trans-Caspian project, a framework in which they could cooperate.

COMMENT

¶10. (C) Although Azerbaijani officials did not mention it during their discussions with energy officer (septel), the issue of who can own the shipping infrastructure for the project is clearly an important one for ConocoPhillips. Chevron does not evidence such concern for its own trans-Caspian project from the Tengiz field, but Chevron's project is smaller-scale and requires much less investment. On a related issue, a maritime infrastructure study by an objective body such as TDA would obviously serve the

BAKU 00000663 003 OF 003

interests of ConocoPhillips. Following one, however, Azerbaijan might realize that this project would bring it more benefits than just transit fees. Post has for a long time argued that the trans-Caspian projects could play a positive role in Azerbaijan's development. A serious study would help solidify and quantify such a concept, serving not only our energy agenda but our larger agenda of economic diversification. For these reasons, post supports the idea of such a study by TDA.
HYLAND